IT 98-6
Tax Type: INCOME TAX
Issue: Replacement Tax Investment Credit/Property Used In Retailing

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE	)	Docket No.
OF THE STATE OF ILLINOIS	)	FEIN:
v.	)	Tax Years Ending 1987, 1989-90
XYZ CORP., INC.,	)	John E. White
Taxpayer	)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION REGARDING THE PARTIES' CROSS MOTIONS FOR SUMMARY JUDGMENT

This matter arose after XYZ CORP., Inc. ("XYZ CORP.") filed amended Illinois income tax returns in which it claimed amounts of replacement tax investment credits for tax years ending December 31, 1987, and for tax years ending December 31, 1989 through 1990. Either by notice or by inaction, the Illinois Department of Revenue ("Department") denied XYZ CORP.'s claims for refund of the replacement tax identified in its amended returns.

During the course of status conferences held in this matter, the parties agreed that this matter was properly the subject of summary judgment, and both parties filed cross motions therefor. I am including within this order and recommendation a brief statement of the material facts not at issue. I recommend that the Department's motion be granted, and that XYZ CORP.'s motion be denied.

Facts Not in Dispute:

1. XYZ CORP. is the parent of ABC COMPANY ("ABC"), and is headquartered in Peoria, Illinois. Department's Motion for Summary Judgement and Memorandum of Law in Support Thereof ("Department's Motion"), p. 2; Taxpayer's Response to Department's Motion for Summary Judgment, Cross-Motion for Summary Judgment, and Supporting Memorandum of Law ("XYZ CORP.'s Motion"), p. 2.

2. ABC is a privately owned combined natural gas and electric public utility company which is engaged in the business of, *inter alia*, producing, transmitting and distributing electrical energy to customers in central and eastern Illinois. Department's Motion, p. 2; XYZ CORP.'s Motion, p. 2; *see also* Central Illinois Light Co. v. Johnson, 84 Ill. 2d 275, 277 (1981) ("The petitioner [ABC] is a privately owned public utility company engaged in producing, transmitting and distributing electrical energy.").

3. The property regarding which XYZ CORP. claimed replacement tax investment credit consists of approximately 8,500 miles of electric conductor lines, as well as poles, towers, transformers, circuit breakers insulators and meters. XYZ CORP.'s Motion, p. 2; *see also* Department's Motion, p. 2.

4. For tax year ending December 31, 1987, XYZ CORP. filed an amended return to claim a replacement tax investment credit refund of $37,771. For tax years ending December 31, 1989 and 1990, XYZ CORP. filed amended returns to claim replacement tax investment credit refunds of $87,587 and $97,102, respectively. Department's Motion, p. 2; *see also* XYZ CORP.'s Motion, pp. 2-3.

5. The Department issued a notice of denial regarding XYZ CORP.'s amended returns filed for tax years 1989 and 1990, which XYZ CORP. protested. XYZ CORP. also

protested the Department's deemed denial of the amended returns XYZ CORP. filed regarding its 1987 tax year. XYZ CORP.'s Motion, p. 3; Department's Motion, p. 2.

Conclusions of Law:

Summary judgment is appropriate when resolution of the case hinges on a question of law. First of America Bank, Rockford, N.A. v. Netsch, 166 Ill. 2d 165, 651 N.E. 2d 1105 (1995); Kirk Corp. v. Village of Buffalo Grove, 248 Ill. App. 3d 1077, 618 N.E. 2d 789 (1st Dist. 1993). Summary judgment is also appropriate when the parties dispute the correct construction of an applicable statute. Bezan v. Chrysler Motors Corp., 263 Ill. App. 3d 858, 636 N.E. 2d 1079 (2nd Dist. 1994). This matter involves the question whether, under § 201(e) of the Illinois Income Tax Act ("IITA"), XYZ CORP., the parent of a public utility company, is entitled to a replacement tax credit for the property ABC used to transmit and distribute electricity.

Here, both parties argue about the language and the correct interpretation of § 201(e)(3), while ignoring, for the most part, the language of § 201(e)(2)(D). While I will address both subsections in this recommendation, I believe the latter forms the more appropriate basis for granting judgment for the Department and against XYZ CORP..

In Balla v. Department of Revenue 96 Ill. App. 3d 293, 295 (1st Dist. 1981), the court set forth the rule regarding who bears the burden in a case involving an income tax credit. Specifically, the court held:

> ... when a taxpayer claims that he is exempt from a particular tax, or where he seeks to take advantage of deductions or credits allowed by statute, the burden of proof is on the taxpayer. [citations omitted] This derives from the fact that

> deductions and exemptions are privileges created by statute as a matter of legislative grace. Statutes granting such privileges are to be strictly construed in favor of taxation.

Balla v. Department of Revenue, 96 Ill App 3d at 295. Here, XYZ CORP. bears the burden of showing, as a matter of law, that it has a clear right to the credit claimed.

Section 201(c) of the IITA imposes a Personal Property Replacement Income Tax ("replacement tax") on every corporation, partnership and trust, for the privilege of earning or receiving income in or as a resident of Illinois. 35 **ILCS** 5/201(c). Section 201(e) grants a credit against a corporation's, partnership's or trust's replacement tax liability for investment in qualified property. 35 **ILCS** 5/201(e). Specifically, section 201(e) provides:

> (e) Investment credit. A taxpayer shall be allowed a credit against the Personal Property Tax Replacement Income Tax for investment in qualified property.
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> (1) A taxpayer shall be allowed a credit equal to .5% of the basis of qualified property placed in service during the taxable year, provided such property is placed in service on or after July 1, 1984.
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> * * *
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> (2) **The term "qualified property" means property which:**
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> (A) is tangible, whether new or used, including buildings and structural components of buildings and signs that are real property, but not including land or improvements to real property that are not a structural component of a building such as landscaping, sewer lines, local access roads, fencing, parking lots, and other appurtenances;
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> (B) is depreciable pursuant to Section 167 of the Internal Revenue Code, except that "3-year property" as defined in Section 168(c)(2)(A) of that Code is not eligible for the credit provided by this subsection (e);
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> (C) is acquired by purchase as defined in Section 179(d) of the Internal Revenue Code;
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> (D) **is used in Illinois by a taxpayer who is primarily engaged in manufacturing, or in mining coal or fluorite, or in retailing; and**

> (E) has not previously been used in Illinois in such a manner and by such a person as would qualify for the credit provided by this subsection (e) or subsection (f).
>
> (3) … **For purposes of this subsection (e), the term "retailing" means the sale of tangible personal property or services rendered in conjunction with the sale of tangible consumer goods or commodities.**

35 **ILCS** 5/201(e) (emphasis added).

XYZ CORP. alleges that its electric transmission and distribution system is qualified property because it is:

> (i) tangible;
> (ii) depreciable under § 167 of the Internal Revenue Code ("IRC" or "the Code") and is not "3 year property" as defined by 26 U.S.C. § 168(c)(2)(A);
> (iii) was acquired by XYZ CORP. by purchase as defined in § 179(d) of the Code;
> (iv) is used by XYZ CORP. in Illinois in retailing operations; and
> (v) has not been previously used in Illinois in such a manner and by such a person as would qualify for the [credit].

XYZ CORP.'s Motion, p. 2.

Conspicuously absent from XYZ CORP.'s motion and accompanying memoranda is reference to subsection 201(e)(2)(D)'s requirement that the property be "used in Illinois *by a taxpayer who is primarily engaged in … retailing*". 35 **ILCS** 5/201(e)(2)(D) (emphasis added). Instead, XYZ CORP. argues that it is entitled to the investment tax credit since it uses the property in conjunction with its sale of commodities, i.e., electricity. *See* XYZ CORP.'s Motion, pp. 13-14.

Specifically, XYZ CORP. argues that the "very essence of [its] position [is that] a taxpayer need not be engaged in selling tangible personal property in order to qualify for the Investment Credit under Act Section 201(e). Thus, a taxpayer engaged in selling

commodities *of whatever nature* may be entitled to the Investment Credit." *Id.* (emphasis original); *see also* Reply Memorandum in Support of Taxpayer's Cross-Motion for Summary Judgment ("XYZ CORP.'s Reply"), p. 2 ("the statute plainly contemplates that a taxpayer engaged in selling 'commodities,' which may be tangible or intangible, can claim the Investment Credit.").

XYZ CORP. argues that the legislature's use of the second "or" in subsection 201(e)(3)'s definition of "retailing" (i.e., the "or" which separates the words "tangible consumer goods" from the word "commodities"), shows that the General Assembly intended the word "tangible", to modify only the phrase "consumer goods," and not the word "commodities." *See* XYZ CORP.'s Motion, p. 8. To complete its argument, XYZ CORP. cites to the case of People v. Menagas, 367 Ill. 300 (1937), and asserts that "[t]he Illinois Supreme Court held long ago … that electricity, which XYZ CORP. concedes is not tangible property, is in fact a commodity." XYZ CORP.'s Motion, pp. 12-13.

While the court, in fact, wrote in its Menagas decision that "[electricity] is a valuable commodity, bought and sold like other personal property" (*see* Menagas, 367 Ill. at 338), that sentence ought not be considered the *holding* of the court in that case. The better statement of the pertinent holding in that case is that electricity could be the subject of larceny, as that crime was defined in section 117 of the Illinois Criminal Code of 1935. *See* Menagas, 367 Ill. at 332 (The court identified the pertinent issue in Menagas by stating, "The question then is: Is electrical energy subject to asportation?").

Moreover, the sentence XYZ CORP. refers to in the Menagas decision must be read in context. That sentence was written in the middle of the following paragraph:

> Counsel say that electricity or electrical energy is not comparable to illuminating gas; that gas is matter, while

> electrical energy is a power, merely. However, this test is announced in the *Woods* case: "There is nothing in the nature of gas used for illuminating purposes which renders it incapable of being feloniously taken and carried away. It is a valuable article of merchandise bought and sold like other personal property susceptible of being severed from a mass or larger quantity and of being transported from place to place." That test is applicable to electrical energy, for it will be seen, as hereinbefore pointed out, that electrical energy may likewise be taken and carried away. It is a valuable commodity, bought and sold like other personal property. It may be transported from place to place. While it is intangible, it is no less personal property and is within the larceny statute. **Cases before this court construing taxing statutes, such as *Illinois Bell Telephone Co. v. Ames,* 364 Ill. 362, and *Peoples Gas Light and Coke Co. v. Ames,* 359 id. 152, holding that the utilities there affected were engaged in service rather than selling, are not inconsistent with the views herein expressed.**

Menagas, 367 Ill. at 338 (emphasis added). When read in context, it is clear that even though the Menagas court held that electricity could be stolen, the court also confirmed its earlier rulings that public utilities were engaged in a service business, and were not engaged in the business of selling — either tangible personal property *or* commodities. *See, e.g.*, Illinois Bell Telephone Co. v. Ames, 364 Ill. 362, 369-70 (1936) ("This court, in *Peoples Gas, Light and Coke Co. v. Ames,* 359 Ill. 152, very definitely set at rest the question whether public utilities … are engaged in the business of selling. It was there held that they are engaged in rendering service rather than in selling.").

Two decades after writing the Menagas decision, the Illinois Supreme Court again reconfirmed its view that electric utility companies were engaged in a service business, in Farrand Coal Co. v. Halpin, 10 Ill. 2d 507, 512 (1957). In that case, a retailer of coal claimed that its sales to a utility company were sales for resale, since coal was merely the energy the utility used to produce electrical energy, thereby making the coal a constituent

part of the electrical energy the utility was engaged in the business of selling. Farrand Coal Co., 10 Ill. 2d at 508-09. The court rejected the retailer's argument generally, and specifically rejected the argument that a utility is engaged in the business of selling electrical energy as property:

> Although this court recognizes electricity as personal property, it has at no time held electricity to be "tangible" personal property. In *Peoples Gas Light and Coke Company v. Ames*, 359 Ill. 152, it was held that gas and electric public utilities were engaged in a service business and not subject to the retailers' occupation tax, and decision as to whether or not electricity was tangible personal property was expressly declined as unnecessary to a disposition of the case.
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> In *People v. Menagas*, 367 Ill. 330, electric current was held to be a subject of larceny under the Illinois Criminal Code. Such decision held only that electric current and energy was personal property as distinguished from real property, and in fact on pages 333 and 338 the court twice referred to electrical energy as being intangible.
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> Most of the authorities relied on by plaintiff holding electricity to be tangible personal property are from foreign jurisdictions involving statutes specifically declaring electricity to be such. Of course, such definition is not present in the instant statute here in issue. The other cases relied on by plaintiff hold electric utility companies to be engaged in manufacturing commodities. Such cases are contrary to the holding of this court in *People ex rel. Mercer v. Wyanet Electric Light Co.* 306 Ill. 377, that electric utility companies are neither manufacturing nor mercantile companies so as to have their capital stock assessed locally instead of by the State assessing authority.
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> * * *
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> The sale of electrical energy generated by the utility through the use or consumption of coal as a service to the utility customers is not, within the ordinary meaning of the statutory language, a sale "of tangible personal property [coal], which property as an ingredient or constituent goes into and forms a part of tangible personal property [electrical energy] subsequently the subject of a 'sale at retail.' "

Farrand Coal Co. v. Halpin, 10 Ill. 2d at 512-13.

The Illinois Supreme Court decisions in Menagas and Farrand Coal Co., therefore, support a conclusion that judgment should be denied XYZ CORP., because they reflect the Illinois Supreme Court's long-standing opinion that public utility companies are not primarily engaged in selling any kind of property. Rather, they are primarily engaged in business as regulated quasi-monopolistic providers of electrical, gas, telephone or other services. *See, e.g.*, Illinois Bell Telephone Co. v. Ames, 364 Ill. at 369-70; Peoples Gas, Light and Coke Co. v. Ames, 359 Ill. 152, 157-58 (1935) (public utility companies not subject to Retailers' Occupation Tax, in part, because the Illinois' Public Utilities Act described "[t]he furnishing of any commodity … as 'service.'"); *see also* People ex rel. Mercer v. Wyanet Electric Light Co., 306 Ill. 377 (1923) (public utility company was not "organized for purely manufacturing and mercantile purposes" so as to exempt it from paying tax on its capital stock)[1]

I find XYZ CORP.'s argument that the language of § 201(e)(3) shows a legislative intent to extend the credit to persons engaged in the business of selling intangible commodities unpersuasive. XYZ CORP.'s Motion, 13-14. I read § 201(e)(3) as including only two related clauses within the definition of qualified property used in "retailing":

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[1] The court distinguished public utilities from mercantile or manufacturing corporations:

> Appellee belongs to the class of corporations ordinarily known and referred to as public utilities. Such corporations form a particular class by themselves and are regulated by special provisions of our statute known as the Public Utilities Act. Merchandise is defined in general as "any movable object of trade or traffic; that which is passed from hand to hand by purchase or sale; specifically the object of commerce; a commercial commodity or commercial commodities in general; the staple of a mercantile business; commodities, goods or wares bought and sold for gain." [citation omitted] Corporations for purely mercantile purposes are well understood by the people in general. They form quite a large class of corporations and are very different in character from corporations known as public utilities.

- the sale of tangible personal property; and
- services rendered in conjunction with the sale of tangible consumer goods or commodities.

XYZ CORP., however, apparently reads § 201(e)(3) as having three clauses. Specifically, XYZ CORP. seems to read that section to include the following activities as being included in the definition of "retailing:"

- the sale of tangible personal property; and
- rendering services in conjunction with the sale of tangible consumer goods; and
- the sale of *tangible or intangible* commodities.

See XYZ CORP.'s Motion, p. 14 (actually, the third activity urged by XYZ CORP. is the act of being "engaged in selling commodities *of whatever nature* ….").

XYZ CORP.'s reading of § 201(e)(3) divorces the second clause from the other related provisions in § 201(e). The word "commodities" is used within the clause relating to property *the retailer uses* to render services in conjunction with *its* sales of tangible personal property. Properly understood, § 201(e)(3) provides that "qualified property used 'in retailing' includes [under the first clause] any property *used by a retailer* to obtain and complete a retail sale, and [under the second clause, any property *used by a retailer*] to perform services in conjunction with the completion of such a sale." *See* American Stores Co. v. Department of Revenue, No. 1-96-4444, slip op., p. 8 (1st Dist. May 1, 1998) (quoted and discussed *infra*, pp. 12-14).

The problem with taking the second clause in § 201(e)(3)'s definition of "retailing" out of context with the other provisions in § 201(e) is that many persons provide services "in conjunction" with the sale of tangible consumer goods or commodities, without being, themselves, primarily engaged in retailing. So, for example, taxpayers who are primarily

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People ex rel. Mercer v. Wyanet Electric Light Co., 306 Ill. at 381.

engaged in the business of providing financing to consumers for the sale of tangible consumer goods, or taxpayers primarily engaged in providing maintenance and/or repair services to point-of-purchase computer terminals used by retailers, would (arguably) both be engaged in providing services "in conjunction with the sale of tangible consumer goods," yet neither would be "primarily engaged in retailing." Reading §§ 201(e)(2)(D) and 201(e)(3) together, it is clear that the General Assembly intended that the taxpayer who claims to be using qualified property to provide services in conjunction with the sale of tangible consumer goods or commodities be the same taxpayer who is selling such tangible personal property — otherwise, such a taxpayer would not be primarily engaged in retailing. 35 **ILCS** 5/201(e); American Stores, No. 1-96-4444, slip op., pp. 8, 12.

Both parties agree that a statute should be read so that no word or phrase in rendered meaningless or superfluous. Department's Motion, p. 5; XYZ CORP.'s Motion, p. 12. So do I. But accepting that "tangible" modifies both "consumer goods" and "commodities" does not render any of the words in § 201(e)(3) meaningless. In their memoranda, the parties contrasted the legal definitions of "goods" and "commodities." Department's Motion, pp. 3, 7; XYZ CORP.'s Motion, pp. 11-12. But in the statute as written, the terms the legislature juxtaposed are "consumer goods" and "commodities." 35 **ILCS** 5/201(e)(3). "Consumer goods" is a term which describes a distinct species of tangible personal property, and that term is defined as "[g]oods which are used or bought for use primarily for personal, family or household purposes. U.C.C. § 9-109(1). Such goods are not intended for resale or further use in the production of other products. Contrasted with capital goods." Black's Law Dictionary 287, 624 (5th ed. 1979).

I agree that the legislature did not intend the terms "consumer goods" and "commodities" to be used interchangeably. A taxpayer that is primarily engaged in selling carloads of coal, or truckloads of widgets, is likely selling tangible commodities, and not consumer goods. Reading the word "tangible" as modifying both "consumer goods" and "commodities" merely reflects the legislature's intent to extend the credit to property used by both retailers and wholesalers of tangible personal property.

Moreover, the only way XYZ CORP. can construe § 201(e)(3) to include "the sale of *intangible* commodities" is through negative implication (i.e., since the legislature did not place the adjective "tangible" immediately before the noun "commodities," they must have really intended that two adjectives — "tangible or intangible" — modify that noun). Such a reading is not ordinarily entertained when construing a statute granting a credit against an income tax liability otherwise lawfully owed. Balla v. Department of Revenue, 96 Ill. App. 3d at 295. I cannot agree that the General Assembly intended the word "tangible " to modify only "consumer goods" and not "commodities," in a manner that completely blurs the line the Illinois Supreme Court has long held to exist between persons primarily engaged in a retailing business and persons primarily engaged in a service business.[2]

XYZ CORP. argues that the circuit court's decision in American Stores Co. v. Department of Revenue, Docket No. 93-L-50584 (November 18, 1996), *aff'd*, American Stores, No. 1-96-4444 (1st Dist. May 1, 1998), requires an expansive construction of

[2] Under XYZ CORP.'s reading of § 201(e) (and again, while purporting to construe § 201(e)(3), I believe it is actually construing § 201(e)(2)(D)), persons who were primarily engaged in marketing intangible commodities (for example, persons primarily engaged in the business of trading pork belly contracts, gold futures, stock options, etc.) would be included under the rubric "primarily engaged in retailing."

§ 201(e). XYZ CORP.'s Motion, pp. 10-13. That specific ruling, which was recently affirmed, was made regarding a different issue than the one presented by the parties' cross-motions in this case.

The American Stores case involved a question of what types of property used by a retailer should be considered to be included within § 201(e)(3)'s definition of property used in "retailing". American Stores, No. 1-96-4444, slip op., p. 3. Specifically, the appellate court addressed whether property used by the retailer at its warehouse, at the retailer's transportation facilities, and at its offices could be included within the definition of the property used "in retailing." *See* American Stores, No. 1-96-444, slip op. pp. 3, 6-7. On administrative review in circuit court, the Department conceded that it would consider taxpayer's property which was physically located at taxpayer's retail stores to be used "in retailing," but claimed that property taxpayer used at its warehouse, at its transportation facilities and at its office could not considered to be used "in retailing." *Id.* Both the circuit court and the appellate court rejected that interpretation of § 201(e)(3). *See id.* p. 8.

The appellate court in American Stores construed the language of § 201(e), and particularly the language of § 201(e)(3), in the following manner:

> … Section 2-201(g) [the predecessor to 35 **ILCS** 5/201(e)] provides that qualified property must be used "in retailing." Under section 2-201(g)(3), retailing specifically encompasses "services rendered in conjunction with the sale" of tangible personal property. Therefore, property used for the purpose of obtaining the sale qualifies for the tax credit.
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> Section 201(g) contains no limiting language requiring that qualified property be located at the retail store. As noted above, the General Assembly provided a more expansive definition of the "retailing" than suggested by the Department, allowing retailers to claim an ITC not only for property used in "the sale of tangible personal property," but also property used to perform "services in conjunction with

> the sale of tangible consumer goods or commodities." **This language includes property located at the retail store or off-site, and demonstrates the legislature's intention that qualified property used "in retailing" includes any property used by a retailer to obtain and complete a retail sale, *or* to perform services in conjunction with the completion of such a sale.**

American Stores, No. 1-96-4444, slip op., pp. 7-8 (emphasis added).

What was *not* at issue in American Stores was the primary business of the taxpayer, who was the corporate parent of the Jewel food store and Osco drug store chains. American Stores, No. 1-96-444, slip op., pp. 1-2. It is within that context that the circuit court's pronouncement regarding the "expansive effect" of § 201(e) must be understood. The appellate court agreed that § 201(e) contained no indicia that the legislature intended to restrict the types of qualified property *retailers used* in their retailing businesses (*see* American Stores, No. 1-96-4444, slip op. pp. 8-9); it did not purport to expand the three classes of businesses eligible to claim the credit. American Stores was a § 201(e)(3) case; it was not a § 201(e)(2)(D) case. The appellate court's decision in American Stores, therefore, is entirely consistent with § 201(e)(2)(D)'s requirement that the taxpayer claiming the credit be primarily engaged in either manufacturing, mining or retailing.

Finally, XYZ CORP. argues that the Department "routinely approves of the Investment Tax Credit for investments in property used in transmitting and distributing natural gas." XYZ CORP.'s Motion, p. 14; XYZ CORP.'s Reply, pp. 7-8. XYZ CORP. asserts that since "[e]lectricity and gas are, in all relevant respects, identical commodities", the Equal Protection clause of the United States Constitution and the Uniformity Clause of the Illinois Constitution require that judgment be entered for XYZ CORP.. XYZ CORP.'s Motion, p. 14. XYZ CORP.'s allegation that the Department allows gas utilities to obtain

replacement tax credit is unsupported by citation to any authority, and is not supported by any well-pleaded fact. XYZ CORP. has not shown a clear right to judgment as a matter of law on its constitutional arguments.

Conclusion:

For all of the foregoing reasons, I conclude that XYZ CORP. is not a taxpayer who is primarily engaged in retailing. Therefore, and as a matter of law, XYZ CORP. cannot establish that its (or ABC's) transmission and distribution property is qualified property "used in Illinois by a taxpayer who is primarily engaged in retailing," as is required by § 201(e)(2)(D) of the IITA. I recommend XYZ CORP.'s Motion be denied, the Department's Motion be granted, and judgment be entered in favor of the Department.

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Date Administrative Law Judge